A Work Project, presented as part of the requirements for the Award of a Masters Degree in Management from the NOVA – School of Business and Economics

How to bring equity investors to the social sector? A quasi-equity approach through the case study of *SPEAK*

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Abstract

As nonprofits do not have access to the same capital markets as for-profit enterprises, organizations usually scramble for funding to keep up with their mission. This scenario can be changed through the use of the right financial engineering. This Work Project aims at studying an innovative financing mechanism based on the concept of quasi-equity for organizations devoted to social ends to cope with their capital needs. A quasi-equity investment model is built for the Portuguese social business SPEAK, and an in-depth assessment of its current financial, organizational and impact situations is conducted. This is a pioneer case study in Portugal.

Keywords: Social Investment, Quasi-equity, Revenue-based Funding, Revenue Participation Agreement

Purpose of the Project – General Overview

The purpose of this project is to develop a social investment model using a quasi-equity instrument for the Portuguese association SPEAK. The properties of the investment were defined taking into consideration the financial and organizational conditions of the organization, so as to guarantee financial sustainability and successful attainment of social goals. For investors, it assures that the risk assumed is compensated.

The report is divided in 4 sections. In order to fully comprehend the applicability of quasi-equity, an analysis of the concept and characteristics of the security was undertaken first hand. Secondly, the foundations on how quasi-equity is applied by social investors in several countries were explored, and a benchmark of existing suppliers was made. The third section includes a comprehensive evaluation of the current situation of SPEAK. Finally, the quasi-equity model was developed, clearly exposing the purpose of the investment needed and the results and impact it aims to achieve.

The kick-off of the work project occurred in February, with an extensive research on the literature for quasi-equity investment. In March, a further research on practical cases across Europe and the USA using quasi-equity was undertaken. At the same time, relevant data and information from SPEAK was gathered through an interview in person with the founder of the association. In April, the information received was screened according to its relevance for the purpose of the work. I kept a continuous communication with the founder of SPEAK via skype and e-mail to assess the work done and clarify doubts that arose during the process. The investment model was developed in May and relevant conclusions were taken from it. To keep track of concluded and forthcoming activities and benchmark the performance against the schedule baseline, biweekly meetings with the Professor were planned.

The Market for Social Investment and Introduction to Quasi-equity

Traditionally, organizations from the social sector have relied on public funding, charity and donations to fund their social mission. The weak financial structuring has made the sector unattractive to invest, mostly because most believe it is unable to generate financial returns. Notwithstanding, some of the most forward-thinking institutions have come to realize that the social sector has the potential to attract differently-motivated investors while offering a different combination of risk and return than conventional businesses. The concept of social investment arises then, bringing capital to organizations with social ends for them to increase their impact and generate alongside a financial return (Cabinet Office, 2013). Social investment can take many forms, and instruments such as loan guarantees, quasi-equity, or social impact bonds have already been tested in real world cases and proven their success on the field.

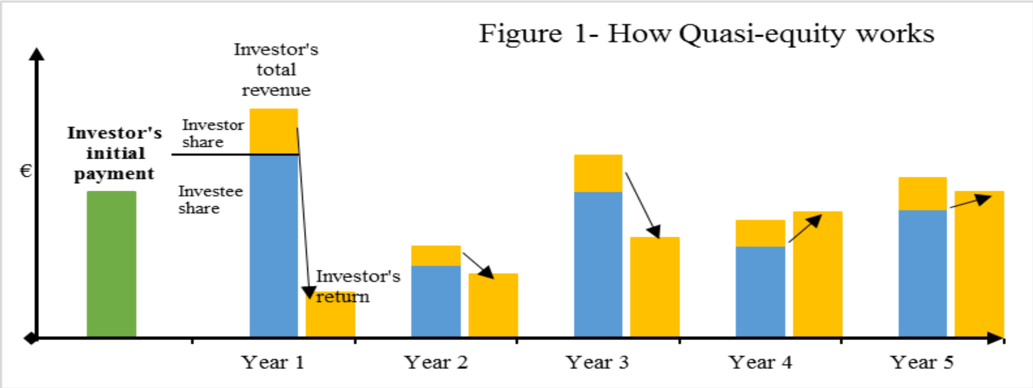
By broadening the access to capital for social organizations, their financial-social return gap is reduced (Bugg-Levine, 2012), whilst investors create a new responsible form of capitalism and engage positively with the community (Big Society Capital, 2015).

According to a report developed by Big Society Capital (2014), social investment in Europe is still very young, standing at a €280M market, and still dominated by grants. The success and growth of the market is highly dependent on its ability to attract different investors' classes. Big Society Capital estimates that high net worth individuals could be the next key investor group, while millennials, who demonstrate high interest on social good, represent a unique opportunity as they will receive a wealth transfer of about $41 trillion. Other institutions such as corporations and institutional investors are increasingly demonstrating a considerable interest in investing in socially responsible investment assets (Big Society Capital, 2014). These prove that the grant-dependency-scenario is changing and that the sector can be attractive for other type of suppliers.

a. Quasi-equity concept and characteristics

For many voluntary organizations debt financing is inappropriate or too onerous due to their volatile revenue streams. At the same time, small business organizations usually do not possess physical assets with which to collateralize a traditional bank loan. On the other hand, equity financing is not possible because of the way social organizations are legally structured (no share issuance). But this legal structure should not be an obstacle for equity investing, especially when most organizations are financially viable, with continued expectation of revenue generation (CAF, 2008. KnowHowNonProfit, 2015. Lighter Capital, 2015. Bugg-Levine, 2012). Quasi-equity comes then as an innovative funding mechanism that copes with both debt and equity financing limitations. It is a hybrid financing instrument that combines some of the benefits of equity and debt (KnowHowNonProfit, 2015). It takes the form of a loan, providing capital with monthly payment terms, but has an important feature of an equity investment as returns are tied to the financial performance of the organization taking hence the structure of a revenue-based funding (Bugg-Levine, 2012).

Hereby, investor and investee share equally the risks and gains of the business. If the future expected financial performance is not achieved, a lower or possibly zero financial return is paid to the investor. If, on the other hand, performance is better than expected, then a higher financial return may be payable (KnowHowNonProfit, 2015) (Figure 1). Quasi-equity is a patient capital, the repayment adjusts up and down with the business. This gives social organizations strong incentives to manage the business efficiently, while investors have incentives to bring rigor to performance management and help the business to grow successfully and quickly.



Source: Cabinet Office, 2015

A quasi-equity investment approach is mostly appropriate to strengthen the balance sheet of nonprofits, so that they have sufficient reserves to invest in future growth or meet unexpected cashflow shortfalls (CAF, 2008).

It is equally important to notice that, like conventional companies, when social organizations receive such equity investment, the organization becomes more valuable and safer for banks or other lenders seeking for returns, creating hence a competitive investment opportunity for organizations. This is a core principle for social investment. By reshaping the financial structure for social organizations to absorb different and new mechanisms of capital provision, the fully subsidization model from donors is left out of the table, and investment capital bringing new funding opportunities can take part of the business (Bugg-Levine, 2012).

The terms and conditions of the lending are structured in practice upon a legal agreement under a Revenue Participation Agreement (RPA). The RPA gives investors the right to a percentage of the future revenue streams generated by the voluntary organization. To mention that this percentage is tied to revenue and not profit, as for most investees profit is not their principal goal, and profitability results can be manipulated. Under the RPA, investors' return is capped (e.g. revenue participation payments cannot exceed twice the principal amount) and/or time limited (e.g. the RPA is extinguished after a certain period of time). The repayment scheme and conditions stipulated in the RPA should reflect both the characteristics and operating situation of the social business as well as the requirements of the investor in order to create a win-win situation for both parties (Cabinet Office, 2015. KnowHowNonProfit, 2015. CAF, 2008).

According to Charities Aid Foundation (2008), there are generally two main approaches for structuring a quasi-equity investment. Either returns are tied to gross revenue, which is relatively easy to calculate and implement and avoids potential misinterpretation between the parties, or returns are tied to incremental revenue which are calculated by taking the gross revenue less restricted grants and/or by defining a threshold level above which the revenue amount is earmarked to quasi-equity investors. This last approach involves a higher risk to investors, who may receive lower monthly amounts than when returns are linked to gross revenue. The simpler the structure chosen, the more workable arrangements become in practice (CAF, 2008).

When compared to a traditional bank loan and equity, quasi-equity investment presents a series of benefits and suits better the characteristics of social organizations. The table below (Figure 2) is a side-by-side comparison of the three instruments, highlighting the advantages of quasi-equity.

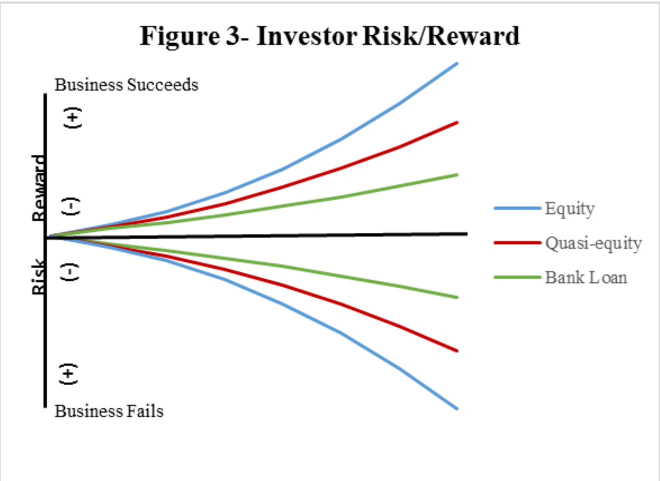
	Bank Loan	**Quasi-equity**	**Equity Investment**
Control	Personal guarantee, financial covenants, ratios	Minimal	Board seat, protective provisions, drag-along
Dilution	None	None	Moderate to extreme
Flexibility/ Leverage	Inflexible fixed payments, high financial leverage risk	Flexible payments, low financial leverage risk	No payments but preference at exit

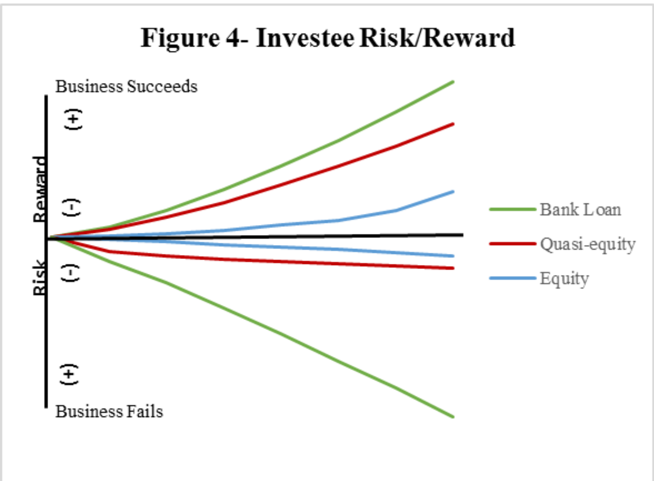
Alignment of interests	Unaligned	Aligned to revenue growth	Growth and exit at all costs, possible goal mismatch
Exit Strategy	Neutral	Not necessary	Required
Cost of Capital	Low	Medium	High

Figure 2- Side-by-side comparison (Bugg-Levine, 2012. Libes 2014. StartupOwl, 2015. Lighter Capital, 2015)

In the case of collapse of the social organization, quasi-equity holders detain a subordinated claim on assets, being paid out after other creditors such as senior debt owners.

Quasi-equity has been labeled as "more expensive than bank loans, but less expensive than equity" for social organizations (Business News Daily, 2014). According to Brittney Helmrich (Business News Daily, 2014), a bank will charge around 6 to 9 percent interest, plus fees, whereas equity investors are generally looking for about 10 times their investment. Quasi-equity sits in the middle, typically bearing a medium financial risk and targeting medium annual return. The graphs below (Figures 3 & 4) illustrate the relationship between risk and reward for bank's loan, quasi-equity and equity financing both for investor and investee.





Source: StartupOwl, 2015

According to Charities Aid Foundation (2008), quasi-equity instrument is accounted as a receivable asset on investees' balance sheet, while for investors it is treated as a liability on the balance sheet.

b. Benchmarking

Nowadays, a considerable number of institutions are lending capital under the form of quasi-equity. Most of them are based in the UK, France and USA. Each sets different criteria and requirements for potential business candidates. Some have clear criterion on the amount of revenues that should already be generated by organizations, others accept only candidates with a least one year in business, while others are fully available for new startups. As criteria of selection vary, the amount lent to investees also diverse. The following table (Figure 5) summarize the funding principles of 5 lenders.

	CAF Ventursome *(charity)*	**Bridges Ventures** *(specialized fund manager)*	**Société d'Investissement France Active** *(solidarity fund)*	**Finorpa**	**Lighter Capital** *(specialized fund manager)*
Security	Quasi-equity	Social Entrepreneur Fund	Prêts Participatifs	Titres Participatifs	Revenue Loan
Country	UK	UK	France	France	USA
Amount lent	Between £25.000 and £250.000	From £300.000 to £1.5M	From €5.000 to €500.000	From €50.000 to €500.000	Between $50.000 and $1M
Payback Term	Up to 5 years	N/A	Up to 7 years	Up to 7 years	Up to 5 years
RPA	Target an IRR of 10% + cap 2 times principal amount	N/A	2% per annum	Fixed rate + variable rate according to self-financing ability	From 1% to 10% of monthly top-line revenue + cap 1.5 to 2.5 times principal amount

Applicants Criteria	Organizations are UK registered but can have their activities anywhere in the world -Have a clear charitable purpose and social impact -Can give evidence of at least one year of income (whether from donations or trading) -Have an annual income of at least £60.000	-Organizations have a clear social mission - Have a robust business model -Are able to scale social impact - Have a strong management team -Operate in sectors such as education, health, sustainable living, underserved communities	-For associations and businesses with social ends that create or consolidate jobs though the development of economic activities	-For established or under development cooperatives operating in the Nord-Pas de Calais region	- For US based for-profit tech companies at an early-stage - Generate at least $200.000 in annual revenue -Have gross margins of at least 50%
Additional conditions of lending	-Charges a 1% upfront commitment fee Underwriting carries a further 1% per annum fee				-Loan is secured against company's assets -Charges a success fee of 25%-50% of principal amount

Figure 5- Benchmarking (CAF, 2015. Bridges Ventures, 2015. France Active, 2015. Finorpa, 2015. Lighter Capital,2015)

While the values of target returns and payback periods are similar across the different lenders, the eligibility criteria for applicants are somewhat dispersed. Some accept candidates with no evidence of income generation, while others have fixed criteria on the annual revenue produced (from $60.000 up). Nevertheless, a common condition is that applicants need to have a clear charitable purpose and clear insights on the social impact they want to generate, as well as a well thought business model that will support their day-to-day operations.

Introduction to SPEAK and Assessments

SPEAK is a Portuguese nonprofit association founded in 2012 that offers a linguistic and cultural program aiming at solving the problem of socio and cultural exclusion in several cities in the country (Speak, 2015). While Portugal is considered by many migrants as a place to work and/or find better living conditions, the challenges they face upon arrival are many. The language, lack of network, lack of legal papers represent key barriers. Moreover, some societies still judge migrants regarding their color, religion, ethnicity (Speak, 2015). As a consequence, problems such as xenophobia, criminality, or unemployment arise, making "communities with different cultures or nationalities to isolate themselves" (Speak, 2015), which foster even more cultural incomprehension, prejudice and stereotypes. Recognizing this social problem, SPEAK came up with a disruptive solution of creating linguistic and cultural exchange courses, using crowdsourcing strategies, in order to integrate migrants in the cities where they live, to fight racism, to promote intercultural dialogue, to create networks of support, and to "help build societies that accept, value and empower cultural diversity" (Speak, 2015). SPEAK initiated its activities in the city of Leiria, scaling the project to the cities of Coimbra and Lisbon in 2nd semester of 2014.

Mission	Vision
We help solving the problem of sociocultural exclusion and help integrating migrants in the cities where they live, with a language and culture exchange program that breaks the linguistic barrier and brings people of different origins together	*Societies that integrate, value and promote cultural diversity. A world that recognizes that there are social problems, that are global and don't respect boundaries, and which solutions require the engagement of all humanity in its full diversity.*

a. Business Model

SPEAK's business model can be described as a "hybrid nonprofit ventures" (Ekington, 2008). Services are delivered to the community excluded by mainstream markets, but there are prospects of making or reinvesting a profit. That is, on one hand SPEAK develops the social axis by acting on the socio and culturally excluded through its linguistic and cultural exchange program. While Portuguese language courses are offered free of charge to migrants, other languages are taught under a voluntarily program and costs €25 per student. On the other hand, SPEAK has developed a business-based service – SPEAK Pro courses- designed to for-profit companies and individuals with specific needs (urgency, focus, intensity and duration) (Speak, 2015). The courses are supported by qualified and experienced teachers. The rationale for this business branch comes from a market opportunity sought by SPEAK, leveraging on the intrinsic knowledge of its operations, which ensures financial sustainability of the association. A portion of total costs is hence recovered through the sales of SPEAK Pro courses. During its pilot phase, and to sustain its activities and scale up projects, SPEAK mobilized funds from philanthropic foundations such as the Fundação Calouste Gulbenkian, Fundação EDP, Fundação Luso-Americana, and Aga Khan Foundation in Portugal (K'cidade program) (Speak, 2015).

b. Assessments

For investments to generate measurable social and environmental impact as well as a financial return, social investors must look out for three main aspects: the current financial situation of the nonprofit, its organizational performance, and the social outcomes it generates. Rational and effective decision-making depends on investor's knowledge across these three fronts (Hornsby, 2013).

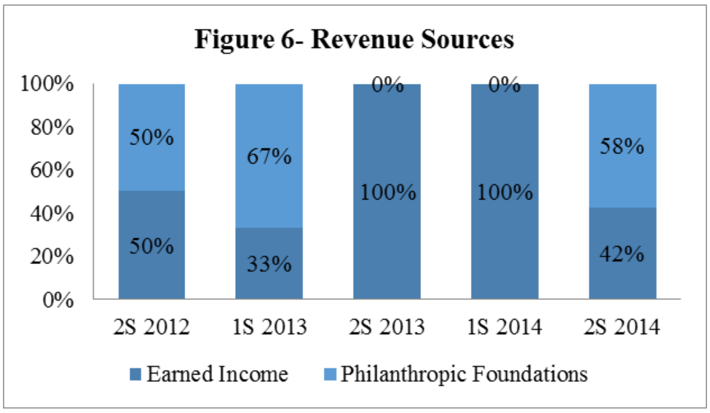
i. Financial Assessment

According to The Bridgespan Group (2015), studying an organization's financial health is of critical importance as it gives investors a clear line of sight into the organization long-term prospects, its ability to overcome unexpected changes in expenses and revenues, and its ability to put additional funds to good use.

In the case of SPEAK, it is a key principal for the team to assure sound management. A strict financial control is exercised, which emphasize the organization ability to survive and grow sustainably. This ability is also stressed in the confidence from funders such as Fundação EDP which invested in SPEAK for three consecutive years.

Examining SPEAK's historical data, operating revenues have grown, approximately, 142% from the 2nd semester of 2012 to the 2nd semester of 2014, demonstrating its business capacity and growing services' demand. In fact, SPEAK was able to grow its total number of beneficiaries year after year (more 335% since 2012). To put the nonprofit strategy into action and achieve results, it needs to expend around €83 per beneficiary. SPEAK has been able to support by itself approximately 72% of this value, which is a good indicator of its financial management strength.

As revenues affect the capacity to provide services, it is crucial that revenues are diversified by sources so that a nonprofit does not become overly dependent on a single one (Chabotar, 1989). In the case of SPEAK, its self-sustainable strategy has proven to be successful over the years. In fact, most of funds received from philanthropic foundations were used to support the launch of the project (reaching a maximum of 67% of SPEAK revenue sources during the 1st of 2013) and to support its scaling strategy (58% in the 2nd semester of 2014).



While reviewing the percentage of costs covered by both the social and business branches, the results are encouraging. These types of sources cover at least 70% of SPEAK's ongoing costs (Figure 7). The formula used for calculation is simply operating revenues over operating expenses. The results show a surplus in the 1st semester of 2014. SPEAK reached its breakeven point at that time, demonstrating that the model works and that it can be self-sustainable. During the 2nd semester of 2014, the organization started to scale the project to other cities, translating in a higher amount of expenses. The decrease of revenues in this period is mainly due to the seasonality of the business in the 2nd half of the year. To mention that SPEAK always had a positive net income thanks to funds received from philanthropies that helped them making a surplus every semester.

	2S 2012	1S 2013	2S 2013	1S 2014	2S 2014
Operating Revenues	7.540 €	16.109 €	14.442 €	26.277 €	18.256 €
Operating Costs	13.044 €	18.611 €	16.804 €	22.423 €	38.450 €
Revenues/costs	*58%*	*87%*	*86%*	*117%*	*47%*

Figure 7- Revenue to Cost Ratio

Operating revenues are, nevertheless, conditional to the team's promotion efforts which is reflected in the number of enrollments. It is hence advisable for SPEAK to partner with different agents (such as universities, Portuguese immigration and borders service, city halls, firms, among others) to ensure a funding model that attracts a mix of clients, making income sources more reliable. This will enable the team to think ahead and set longerterm goals and priorities with confidence in the resources it will be able to spend on services provision.

To cover ongoing expenses, a nonprofit needs to assure access to sufficient liquid assets in case revenues do not come in as planned. That is, it needs to guarantee enough cash reserves so as to pay for bills and cover payroll. The amount of cash an organization needs to have on hand depends not only on how much it spends, but also on the timing of its revenues and expenses (The Bridgespan Group, 2015). In the case of SPEAK, cash influx are stronger during the first three months of the year and in September, October and November coinciding with the enrollment periods. On the other hand, cash outflow appear at a monthly basis. Looking to the nature of SPEAK's expenses, more than 60% of them are fixed costs (Figure 8), and comprise mostly employees on the payroll (more than 60% - Figure 9). That is, SPEAK has used more operating leverage. This can be particularly dangerous in the case of small errors in forecasting sales and revenues, as the impact on cash flow's projections to support ongoing expenses is significant. Therefore, there is a need to plan ahead and keep the necessary amount of cash on hand to make payments. SPEAK has approximately three months' worth of expenses in ready cash, giving the association a reasonably comfortable cushion (The Bridgespan Group, 2015). During periods of lower revenue entrance, SPEAK deploys more efforts into improving organizational processes, translations and/or B2B sales. In case the nonprofit is not able to grow revenues as expected, it will cut on the number of team members, lowering fixed costs.

Figure 8- Operating leverage

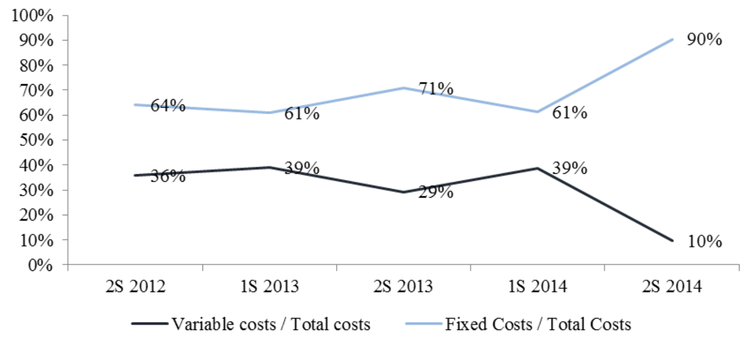
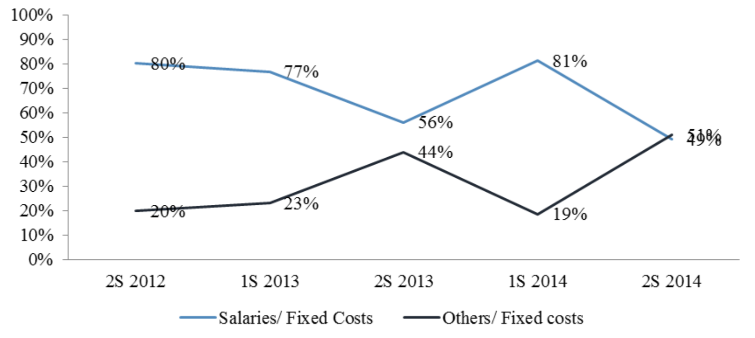


Figure 9- Fixed Costs



ii. Organizational Assessment

To support the achievement of results, organizations need to have in place some set of organizational capacities. For investors, an in-depth knowledge of the performance of organizations they intend to fund is extremely valuable as to guarantee effective-decision making (Jones, 2006). For SPEAK, good performance is linked to the number of beneficiaries the organization is able to support, to the change it creates in beneficiaries' life and in the society in general, to its ability to raise funds and generate revenues, and its ability to employ resources efficiently. The organization has been able to continuously grow on the number of enrollments and beneficiaries impacted. It has done so by keeping a relatively stable cost per beneficiary (Figure 10). SPEAK has been working as an effective and efficient program, successfully meeting its purpose of helping communities to come together and share their languages and cultures.

	2S 2012	2013	2014
Beneficiaries SPEAK Social	135	276	578
Beneficiaries SPEAK Pro	30	140	140
Total Beneficiaries	**165**	**416**	**718**
Cost per beneficiary	*79 €*	*85 €*	*85 €*

Figure 10- SPEAK Beneficiary data

SPEAK has also been able to take advantage of external resources to put its service in place. For example, it partners with schools in the city of Leiria that provide rooms for the language courses, or with the British Council institution that helped in the development of teaching materials. Due to the mobility of the project, it is relatively easy for SPEAK to adapt to the external context in which it operates and to pull out of cities where it does not reach the expected impact. As the number of foreigners in Portugal is growing (especially due to increasing number of student permits' holders) (Público, 2015), SPEAK has an expansive sense of purpose and continues to be relevant to its stakeholders. Integration challenges will keep emerging, converging as an indicator for new business opportunities for SPEAK.

SPEAK opted for a horizontal organizational structure as the organization is relatively small, comprising 5 elements. The team manages the project for every city where it is implemented, while every member as a clear function inside the organization. This enables the business to be more scalable. Every element takes a part in the decision-making process and management styles are more informal than formal. A culture of teamwork is also fostered inside the organization. To ensure that SPEAK successfully achieve its purpose, the whole spectrum of stakeholders needs to share the mission and vision of the organization and need to be aligned with its values. This include assuring that employees are motivated to work towards organizational goals and aspirations. SPEAK implemented an incentive system that links rewards to financial results and staff performance. To manage volunteers' motivation, a rigorous recruitment process is put in place, the level of commitment and motivation is measured promptly, and a vast number of events are organized for them to integrate. However, it still needs to define a process to guarantee the quality of teaching of volunteer's professors so that results are not compromised. Strategic partners also need to be supportive of what the organization is intended to accomplish, and a principle of transparency and good communication is established between both parties.

iii. Impact Assessment

SPEAK is purposed in solving the problem of socio and cultural exclusion in Portugal, which ultimately leads to problems such as criminality, unemployment, rough sleeping, among others. The program aims at integrating migrants in the cities where they live, empowering individuals and communities, breaking down prejudice and misconceptions and promoting greater understanding and cooperation between cultures (Blog Speak, 2014). To understand if the organization is reaching its goals, SPEAK is committed in evidencing its social impact and draw lessons to improve and develop future strategies. A survey system for measuring and reporting social changes has been implemented, where participants of SPEAK Social are asked to fill out an anonymous survey at the beginning of the program, and the same survey again at the end (5 months period). The idea is to compare results from the start of the semester with results of the end of the semester regarding three main indicators: integration levels of the participants, multicultural appreciation, and cultural diversity awareness. These dimensions are convoyed in 8 statements, which participants are asked to rate on a scale of 1(totally disagree) to 9 (totally agree). Two extra statements are added at the end of the semester survey in order to assess the participants' perception of the project social mission. In the 1st semester of 2013, the outcomes obtained in Leiria were very positive, demonstrating the importance and relevance of the project. On average, the level of agreement with the statements increased 20% in a 5 month period, indicating that participants felt more integrated in the cities where live in, more warned of the diversity surrounding them, and attributed greater importance to cultural diversity. Furthermore, when asked if participants would recommend SPEAK to family and friends, 98% of participants answered "YES" (Blog Speak, 2014). Altogether, SPEAK helped Portuguese participants to learn more about the world and to develop their language skills, it helped migrants obtaining the Portuguese nationality, finding jobs, learning Portuguese, it made people come together and it created informal support networks among its participants.

A Quasi-equity Investment model proposal

a. Scalability and Investment needed

SPEAK is currently present in 3 cities – Coimbra, Leiria, and Lisbon and its social business has already benefited more than 989 individuals since 2012. The P&L breakeven reached by the social business in Leiria testify that the model can be self-sustainable. Nevertheless, it takes, approximately and in an optimistic scenario, 2.5 years to reach a large enough market share for SPEAK Pro program and create a large enough volume of sales that supports financially whole SPEAK's operations. This speed of scalability and growth compromise the potential social impact that could be achieved. This is due to the exceeding time that SPEAK's team needs to allocate to SPEAK Pro sales (50%). A new strategy needs hence to be set up so as for SPEAK to focus efforts into its social mission and grow on the number of beneficiaries impacted. By improving processes through automation, the organization can implement an organizational model with a performance superior than the actual one. As the team would be focused into developing and implementing the model, time allocated to SPEAK Pro courses' sales is reduced and income to support core operations is lost. Therefore, it ideally requires grant money to bolster its cash reserve so that it can compensate for the revenues lost.

b. Expected Impact

As the problem of socio and cultural exclusion is transversal to several Portuguese cities, SPEAK's social impact can be scaled to other areas. With the investment received, it expects to benefit 1200 beneficiaries by 2015, 2400 in 2016, and 5000 beneficiaries in 2017. This is more 4400 beneficiaries per year than the current model allows to reach. This number is likely to grow even more due to the current surge of refugees crossing the Mediterranean Sea, Portugal being held responsible to give asylum to over 704 refugees per year according to a European Commission proposal (Económico, 2015). By 2017, 65% of revenues are expected to derive from SPEAK Social program, using 80% of the team's efforts in its sale and promotion.

Much still needs to be done to what concerns the adoption of policies that facilitates the integration of migrants into society. According to Público (2015), the contributions of migrants to the society are very beneficial. They represent €240millions of net contribution to the social security, and create six times more work positions than the Portuguese, increasingly creating jobs for the Portuguese. Working towards promoting social inclusion and cultural comprehension strengthen the sustainability of communities, reaping the benefits of engaged citizens.

c. Building the Model

Due to the seasonality of the business and high operating leverage of SPEAK, a quasi-equity investment is appropriate as repayments are scaled to revenues and offers low financial leverage risk for the organization. Although the investment carries a high risk for a potential investor, as there are no certainty that the new scaled-up business will work, SPEAK's forecasts were based on well-researched and reasonable assumptions. For projecting revenues, a bottom-up financial approach was used. That is, revenues were predicted using steady state values for each city where SPEAK is currently located (Lisbon and Coimbra) and for new cities where it aims at developing business. This rule was applied for the 2 branches of the program (Social and Pro). By 2015, the organization expects to scale to two more cities with similar characteristics to Leiria and growing revenues 74% more than the previous year. To mention that prices of services offered will increase in the 2^{nd} half of 2015. For 2016, it also foresees growing to two more areas, increasing revenues by 41%. By 2017, it predicts raising revenue by 43% and attain four new cities. Variable costs' estimates from 2015 to 2017 were made using the same approach, using percentages of steady states values for the cities of Lisbon and Coimbra, while the city of Leiria kept a steady value considering an average of previous years' variable costs for the city. Fixed costs were calculated adjusting to the growing business expectations, increasing the number of staffs, rents and other miscellaneous costs, and increasing investments in promotion and automation. SPEAK expects that fixed costs grow 123% from 2014 to 2015. Due to the investment in capacity building, the scale up model is likely to benefit from economies of scale and efficiency gains. Since the major portions of costs are fixed, it is predictable that the burden of fixed costs will be leveraged over the years. By 2016, the growth rate of fixed costs is predicted to decrease to 7%, and in 2017 to grow at a 14% rate. For the years 2017 on, the average annual growth rate (AAGR) of total revenues was projected based on historical growth trends. An optimistic, average and pessimistic scenarios were developed, using variations of AAGR of total revenues. As the historical AAGR was, approximately, of 46%, a rate of 30% was used to compute the base scenario. Total costs growth rate was estimated 20% for this scenario.

The optimistic scenario assumes an AAGR of revenues of 40%, and 15% for expenditures. Finally, in the pessimistic case, an AGGR of 15% for revenues was predicated and 10% for total costs. The following graphs (Figures 11 & 12) illustrate the growth of revenues and the growth of revenue margins for the 3 scenarios.

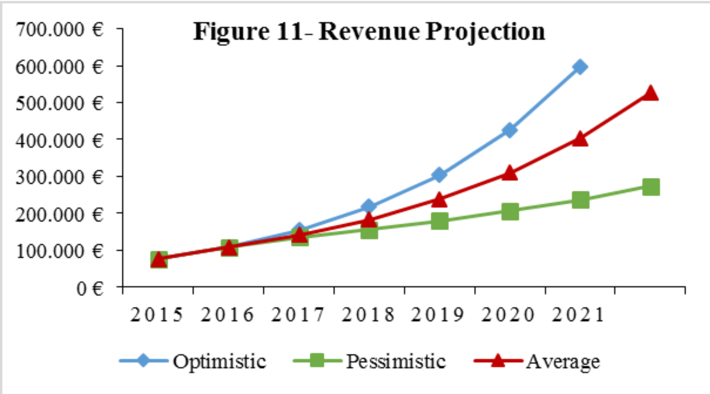


Figure 11- Revenue Projection

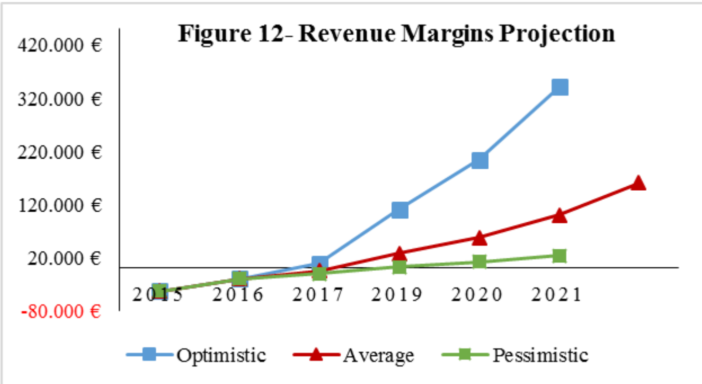


Figure 12- Revenue Margins Projection

The amount of investment needed to support improvements in organizational processes, and to keep SPEAK sustainable in the long-term, was projected taking into account the minimum value of cumulative net income. In addition, a working capital contigency fee of 20% of the investment required was added to guarantee the organization has enough cash available for day-to-day operations. The investment quantity varied across the three scenarios, and accounted for €125.374 in the base scenario, €105.933 in the optimistic and €157.640 in the conservative one.

Under the RPA, the investor is entitled of a Revenue Participation Right (RPR) of 8% of SPEAK's gross annual revenue, payable annually. The decision to link returns to gross annual revenues rather than incremental was due to the difficulty to identify a baseline for revenues and to make the process simple and more workable. The percentage of royalty payment was computed to ensure the fastest repayment scheme for the investor and assure financial sustainability for SPEAK and impact maximization. The quasi-equity investment is structured so that return is capped at 1.2 times the initial investment size. When cumulative total payments to the investor reach this amount, the RPR is extinguished. With an 8% royalty payment attached to the RPI, the Internal Rate of Return (IRR) for the average scenario, which represent the maximum profitability rate of the project, is 3.31%. A 2% discount rate was used, which is a reasonable value for social projects according HM Treasury (2011). The Net Present Value (NPV) attached to the base scenario is €9.207. The payback period to recoup funds expended in the investment is of 8 years for this base scenario. In the optimistic case, the IRR accounts for 3.83% and the NPV €9.471. The expected payback period is of 7 years. For the pessimistic scenario, the project generates an IRR of 2.58% and the NPV associated is €6.428. 11 years are needed to payback the investment made.

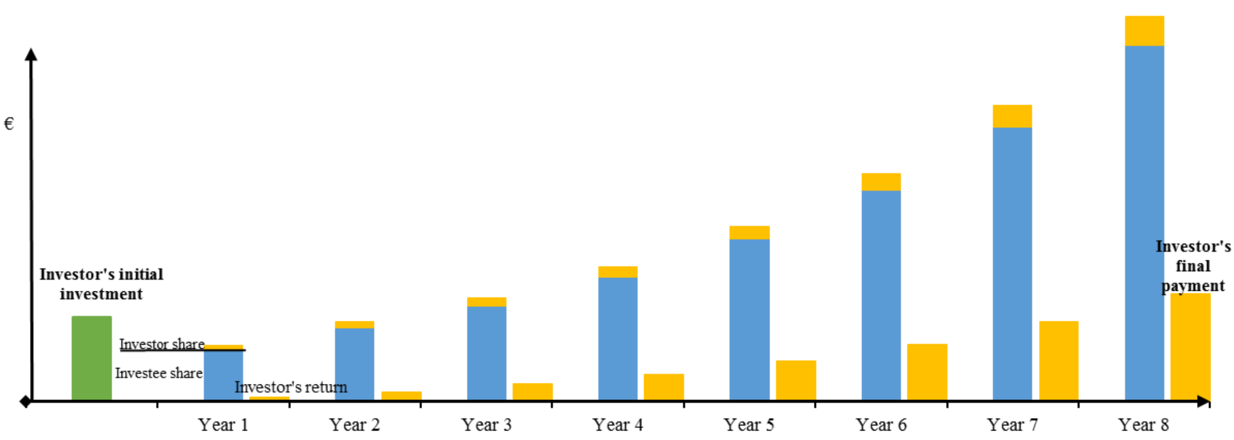
The figures below (Figure 13 & 14) illustrate the quasi-equity instrument structure for a series of forecast revenues in the base scenario.

Period	0	1	2	3	4
Year	**2014**	**2015**	**2016**	**2017**	**2018**
Forecast Revenue		77.318 €	108.872 €	141.534 €	183.994 €
Income stream for investors	-125.374 €	6.185 €	8.710 €	11.323 €	14.719 €
Present Value	-125.374 €	6.064 €	8.372 €	10.670 €	13.599 €
Cumulative NPV	*-125.374 €*	*-119.310 €*	*-110.938 €*	*-100.269 €*	*-86.670 €*
Net Present Value	9.207 €				
Income stream for SPEAK		71.132 €	100.162 €	130.211 €	169.274 €
Cumulative revenues		*71.132 €*	*171.294 €*	*301.505 €*	*470.779 €*
Costs		120.736 €	128.647 €	146.647 €	175.976 €
Net income		-49.604 €	-28.485 €	-16.436 €	-6.702 €
Cumulative net income		*-49.604 €*	*-78.089 €*	*-94.525 €*	*-101.227 €*

Period	5	6	7	8
Year	**2019**	**2020**	**2021**	**2022**
Forecast Revenue	239.192 €	310.949 €	404.234 €	525.504 €
Income stream for investors	19.135 €	24.876 €	32.339 €	33.162 €
Present Value	17.331 €	22.089 €	28.153 €	28.303 €
Cumulative NPV	*-69.339 €*	*-47.250 €*	*-19.097 €*	*9.207 €*
Net Present Value				
Income stream for SPEAK	220.056 €	286.073 €	371.895 €	492.342 €
Cumulative revenues	*690.836 €*	*976.909 €*	*1.348.805 €*	*1.841.147 €*
Costs	211.172 €	253.406 €	304.087 €	364.905 €
Net income	8.885 €	32.667 €	67.808 €	127.438 €
Cumulative net income	*-92.342 €*	*-59.675 €*	*8.133 €*	*135.571 €*

Figure 13 - Revenue Participation Agreement for Base Scenario

Figure 14 - How the RPA works for the base scenario



Conclusions

So far, it was revealed that an investment using quasi-equity is appropriate for SPEAK's intent of implementing a growth strategy to improve processes, and consequently expand services and reach more beneficiaries. As the specificities of model demand for extensive efforts to generate revenues, it encourages SPEAK to develop a model even more sustainable. The skilled management team as well as the good financial management proven so far, should be sufficient arguments for social investors to take a part of its growth process, and give the financial support for the social business to thrive. Nevertheless, and despite the reasonable assumptions made throughout the RPA model development, the risk attached to the strategy's uncertainty can never be entirely eliminated. But it can be mitigated and actively managed. Over-optimistic financial assumptions can lead to difficulties in achieving financial milestones, and consequently repayment to the investor might be harder than initially thought. It is hence advisable for SPEAK to review frequently the assumptions underlying income projections, taking in consideration both internal and external factors that may affect the outputs of the model. It should include more variables to stress-test financial projections of the model. The 3 scenarios developed only assume changes in total revenues, but other elements might affect financials (e.g. changes in tax obligations. changes in variables that affect Speak Pro sales, changes in revenues for each city rather than total revenues). This is especially relevant due to the little surplus SPEAK has in reserves. Additionally, an investor willing to cooperate with SPEAK should check assumptions too and recommend the organization on the most realistic model through the due diligence process. The investor must also guarantee that the organization is putting its efforts in achieving its social mission, and is not deviating from its social goals so as to be profitable and repay for the investment. A continuous assessment of the social impact from the investor should hence take place, requiring a good monitoring and evidenced outcomes. Finally, good communication between both parties throughout the term of the RPA should be ensured so as investor to be kept up-to date of the direction of SPEAK and on the successes and, mostly, difficulties encountered along the day-to-day operations. Only that way successful results and positive changes can be achieved.

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Appendices

	2S 2012	2013	2014
Operational Revenues	7.540 €	30.551 €	44.533 €
SPEAK Revenues	7.540 €	30.273 €	40.218 €
SPEAK Social	528 €	4.592 €	7.219 €
SPEAK Pro	7.012 €	25.274 €	32.999 €
Classic	*5.712 €*	*13.918 €*	*10.966 €*
Crash	*1.108 €*	*8.528 €*	*14.743 €*
Others (Verão...)	*192 €*	*2.460 €*	*3.674 €*
Translations	*0 €*	*368 €*	*3.616 €*
Merchandising	0 €	407 €	0 €
Donations	0 €	278 €	4.315 €
Operational Costs	13.044 €	35.415 €	60.873 €
Variable Costs	4.680 €	12.169 €	12.383 €
Services	*4.362 €*	*11.940 €*	*12.243 €*
Others (Verão...)	*318 €*	*229 €*	*140 €*
Fixed Costs	8.364 €	23.246 €	48.490 €
Staff wages	*6.709 €*	*15.400 €*	*28.238 €*
Others (Verão...)	*1.655 €*	*7.846 €*	*20.252 €*
Operational income	-5.504 €	-4.864 €	-16.340 €
Investment Received	7.500 €	32.500 €	24.773 €
Net income	**1.996 €**	**27.636 €**	**8.433 €**

Figure 1 - P&L Account SPEAK 2nd semester 2012, years 2013 and 2014

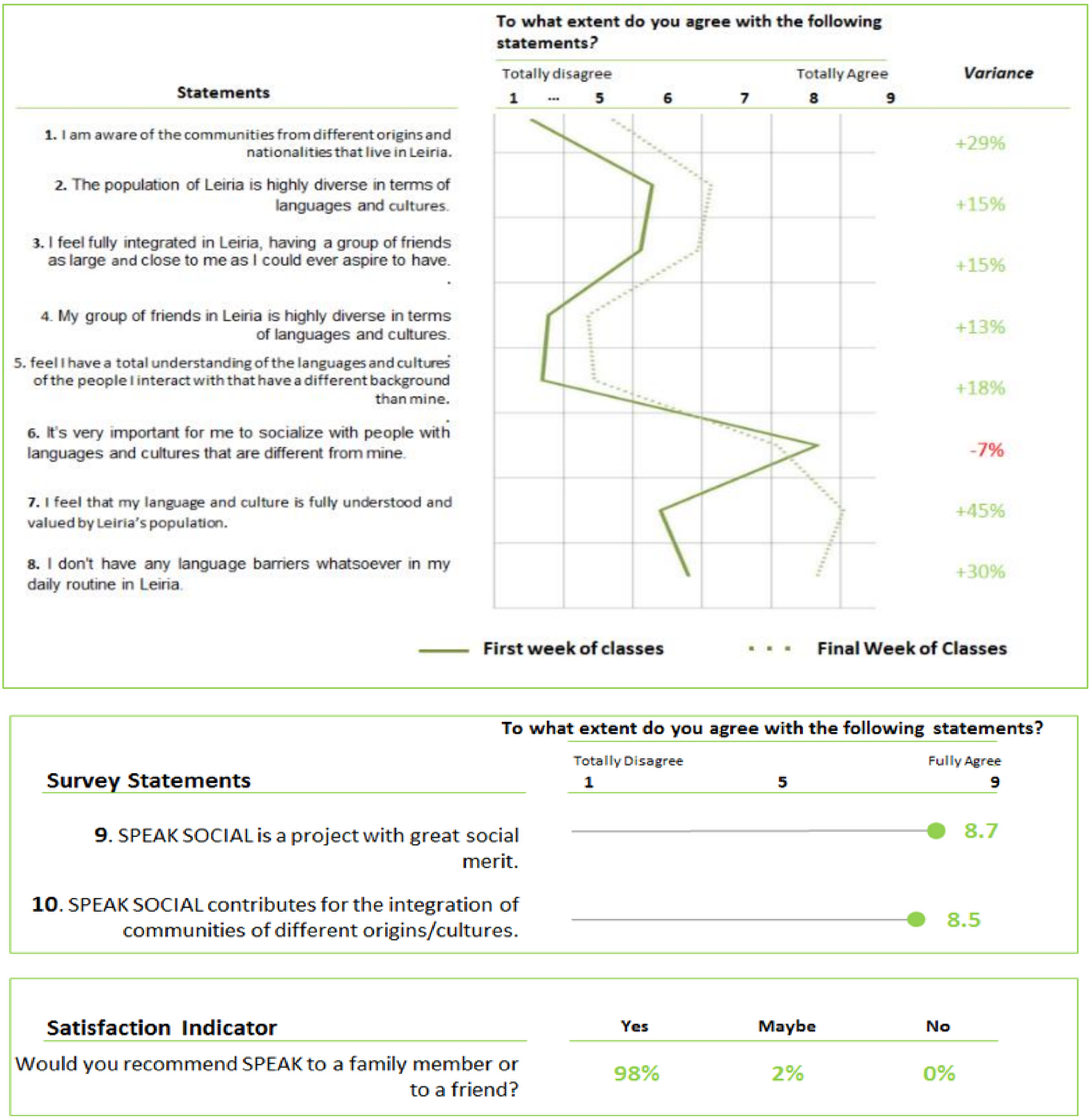

Figure 2 - SPEAK Social Impact Survey (Blog Speak, 2014)

Period	0	1	2	3
Year	**2014**	**2015**	**2016**	**2017**
Forecast Revenue		77.318 €	108.872 €	155.380 €
Income stream for investors	-105.933 €	6.185 €	8.710 €	12.430 €
Present Value	-105.933 €	6.064 €	8.372 €	11.713 €
Cumulative NPV	*-105.933 €*	*-99.869 €*	*-91.498 €*	*-79.784 €*
Net Present Value	9.471 €			
Income stream for SPEAK		71.132 €	100.162 €	142.950 €
Cumulative revenues		*71.132 €*	*171.294 €*	*314.244 €*
Costs		120.736 €	128.647 €	146.647 €
Net income		-49.604 €	-28.485 €	-3.697 €
Cumulative net income		*-49.604 €*	*-78.089 €*	*-81.786 €*
Period	4	5	6	7
Year	**2018**	**2019**	**2020**	**2021**
Forecast Revenue	217.532 €	304.545 €	426.363 €	596.908 €
Income stream for investors	17.403 €	24.364 €	34.109 €	23.919 €
Present Value	16.077 €	22.067 €	30.288 €	20.823 €
Cumulative NPV	*-63.707 €*	*-41.640 €*	*-11.352 €*	*9.471 €*
Net Present Value				
Income stream for SPEAK	200.129 €	280.181 €	392.254 €	572.989 €
Cumulative revenues	*514.373 €*	*794.555 €*	*1.186.808 €*	*1.759.797 €*
Costs	168.644 €	193.941 €	223.032 €	256.487 €
Net income	31.485 €	86.241 €	169.222 €	316.502 €
Cumulative net income	*-50.301 €*	*35.940 €*	*205.162 €*	*521.664 €*

Figure 3- Revenue Participation Agreement for Optimistic Scenario

Period	0	1	2	3	4	5
Year	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Forecast Revenue		77.318 €	108.872 €	136.090 €	156.504 €	179.979 €
Income stream for investors	-157.640 €	6.185 €	8.710 €	10.887 €	12.520 €	14.398 €
Present Value	-157.640 €	6.064 €	8.372 €	10.259 €	11.567 €	13.041 €
Cumulative NPV	*-157.640 €*	*-151.576 €*	*-143.204 €*	*-132.945 €*	*-121.378 €*	*-108.337 €*
Net Present Value	6.428 €					
Income stream for SPEAK		71.132 €	100.162 €	125.203 €	143.983 €	165.581 €
Cumulative revenues		*71.132 €*	*171.294 €*	*296.497 €*	*440.480 €*	*606.061 €*
Costs		120.736 €	128.647 €	146.647 €	161.312 €	177.443 €
Net income		-49.604 €	-28.485 €	-21.444 €	-17.329 €	-11.862 €
Cumulative net income		*-49.604 €*	*-78.089 €*	*-99.533 €*	*-116.861 €*	*-128.724 €*

Period	6	7	8	9	10	11
Year	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
Forecast Revenue	206.976 €	238.022 €	273.726 €	314.784 €	362.002 €	416.302 €
Income stream for investors	16.558 €	19.042 €	21.898 €	25.183 €	28.960 €	24.826 €
Present Value	14.703 €	16.577 €	18.690 €	21.072 €	23.757 €	19.967 €
Cumulative NPV	*-93.634 €*	*-77.057 €*	*-58.368 €*	*-37.296 €*	*-13.538 €*	*6.428 €*
Net Present Value						
Income stream for SPEAK	190.418 €	218.980 €	251.828 €	289.602 €	333.042 €	391.476 €
Cumulative revenues	*796.479 €*	*1.015.459 €*	*1.267.287 €*	*1.556.889 €*	*1.889.931 €*	*2.281.407 €*
Costs	195.187 €	214.706 €	236.177 €	259.794 €	285.774 €	314.351 €
Net income	-4.769 €	4.275 €	15.651 €	29.808 €	47.268 €	77.125 €
Cumulative net income	*-133.493 €*	*-129.218 €*	*-113.567 €*	*-83.760 €*	*-36.492 €*	*40.634 €*

Figure 4- Revenue Participation Agreement for Pessimistic Scenario